CONCORD AidWatch input OECD's Development Assistance Committee (DAC) senior level meeting on 3-4 March

CONCORD AidWatch welcomes the opportunity to contribute to the forthcoming debates of OECD-DAC Senior Level meeting which will discuss development finance and especially ODA modernisation. That being said we would like to see this to go a step forward in officially soliciting inputs from CSOs and partner countries through formal consultations. We believe that Civil Society's involvement will increase ownership and bring additional added value to the debates. Finally there needs to be more time for developing submissions to allow various stakeholders especially the CSOs from partner countries to determine consensus positions and effectively consult their constituencies. The timeframe for this submission was not sufficient enough to develop a clear position on all of the issues discussed.

This submission cannot be considered a consensus document due to the short preparatory timeframe but is based on the input from a wide range of European CSO groups. It addresses the documents indicated in the call for comments and the broader positions of CONCORD AidWatch.

I. Options for modernising the ODA Measure

CONCORD AidWatch believes all three options for modernized ODA measure submitted by DAC Secretariat potentially present strengths and weaknesses, but it must be noted that, there is currently insufficient data to accurately assess the three proposed options.

CONCORD AidWatch considers that:

a. ODA should account for **resources that explicitly focus on poverty eradication and achievement of development goals**.
    - On this basis guarantees and other risk sharing mechanisms should be excluded from the future ODA measure unless than can clearly demonstrate additionality in poverty eradication and achievement of development goals.
    - In-donor costs that are not targeted towards poverty eradication and achieving development goals should also be excluded on the same basis.
    - Resources provided by ODA should be needs based and not tied.

b. **Reporting should be done in net terms** in order to account for actual flows.
    - Loans and equity should be reported in net terms to account for actual flows between donors and recipients.

c. **Technical assistance** if included in the new framework should be needs based and should not be tied neither formally nor informally.

d. Counting capital expenditures to non-grant delivering agencies such as **DFIs** could be problematic as structures and support are not uniform across donors. For example, some DFIs operate more as export credit agencies where there is difficulty in demonstrating development outcomes. Others are tied to the commercial interests of donors.

e. **Non-debt based forms of development finance** should be prioritised and debt based instruments should be carefully assessed against clear development criteria and additionality before being included in the new measure.

f. **Concessionality** criteria should be revised and updated:
  - Only the grant equivalent should be counted as ODA.
  - The discount rate should reflect current economic conditions.
  - If the current system is maintained, returns on interest should be deducted to better reflect the actual transfer of flows.
  - Debt sustainability criterion for ODA loans should be added.

II. On the new measure of Total Official Support for Development

Valorising OECD DAC members' efforts to mobilise additional resources for development from the private sector and employ market-like financial instruments requires serious reflection. While the OECD DAC has a history of working on ODA it is not the right fora to determine the developmental character of other financial flows.

However, within the discussion the OECD DAC should carefully consider the following:

- **Development results** should be the ultimate goal of Development Finance.

- All ODA should be aligned with internationally agreed **inclusive development effectiveness principles and commitments.**

- **The additionality and leverage effect** of resources mobilized from the private sector for development needs to be clearly demonstrated, evidenced and aligned to development principles and national development strategies.

- **Opportunity costs** of market-like instruments could be high and detract from resources needed to support social sectors and must be carefully considered.

- More attention must be paid to **transparency and accountability**. New measures and methods should be clear, evidence-based, transparent and reproducible.

Therefore, CONCORD AidWatch states the following:

a. Amounts mobilised by **guarantees must demonstrate clear additionality for poverty eradication and contribution to the achievement of the development goals before being considered as ODA**. Amounts mobilised by **guarantees should be carefully assessed before included in a broader measure**: It is difficult to assess the development objectives of amounts mobilised through guarantees. An alternative would be to only include in the possible broader measurement of the amount covered by official donor agencies but this also suffers from the same problems of additionality and consists of funds with a high opportunity cost - using amounts covered by official donor agencies to support guarantees that would not be transferred to partner countries but only activated on project failure, means that those resources cannot be used elsewhere. Given current budget constraints, these opportunity costs may be particularly high in countries or sectors where the need for straightforward public investment is critical such as in climate adaptation, health, or education.

b. The **cancellation of unpayable debts** is important, but it should not be counted as aid. First, in their cancellation donors can count both the principal and future interest: since many of the debts are long-term, counting future interest can inflate the figure significantly. Secondly, the relationship between the debt and development objectives is often unclear. Research conducted by Eurodad shows that 85% of the bilateral debts cancelled between 2005 and 2009 were debts resulting from export credit guarantees.[1] The mandate of export credit agencies is to support national (donor) companies by encouraging their international exports, but not to support development of partner countries. Moreover, donor countries often lend irresponsibly and can contribute to increase the debt of developing countries. Debt relief should reflect the position outlined in the Monterrey Consensus[2] and should not detract from ODA resources.

c. **Mezzanine finance** suffers from similar problems as guarantees (please see above). Without a clear, evidence-based, transparent and reproducible method to determine the amount of finance mobilised and a clear assessment of the development purpose of these flows their additionality cannot be assumed.

d. Capturing gross equity disbursements can be useful in order to show how much money has been invested per year but in this case the returns are important as well as they represent a direct financial flow out of partner countries**.** Therefore, **equity** should be measured in net terms in order to capture transfers between donors and partners. The assumption of the crowding in effect of equity investments would also have to be clearly demonstrated.

e. **Other official flows (OOF)** (excluding export credits) could be included in a broader measure. Data on gross and net disbursements should be available to ensure transparency and a clear understanding of what proportion of such flows return to the donor country.

f. **Tax concessions** should not be included in the broader measure. Not all OECD countries provide tax concessions for donations to NGOs in general as this reduces taxable income significantly in some cases. In addition, it is difficult to make a distinction between development and non-development NGOs as there is no clear existing internationally agreed definition. Including tax concessions in the broader measure would contravene principles of policy coherence as tax exemptions are seen as a leakage of revenues in developing countries themselves, many of whom exempt ODA funded activities from VAT, income tax, and customs taxation. Such leakages directly undermine efforts to increase domestic resource mobilisation in partner countries, currently a priority theme of development

[1] Eurodad (2011), Exporting goods or exporting debt? Export credit agencies and the roots of developing country debt

[2] http://www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf

cooperation efforts, as it would encourage a Northern tax exemption at the expense of Southern development finance.

g. Instead, DAC countries should agree with recipient countries on removing **tax exemptions** in developing countries so that ODA recipients would also pay taxes, as for example the Danish[3] and Norwegian[4] Government has already done.

h. **No tax exemptions/ concessions should be deducted from ODA**, but rather what should be examined are the cost / benefit and leakages of tax exemption given to ODA funded projects, staff and goods in developing countries. In Tanzania, there are studies of how much loss of Domestic Public Resources takes place due to the tax exemption of ODA funded projects - and how much this contributes to a lower tax morale and willingness of other taxpayers to pay crucial taxes that fund vital public services[5].

III. Defining Concessional Character

Creating the appropriate incentives in donor reporting of concessional loans is critical to ensuring positive development outcomes. Future forecasting by the OECD DAC indicates that grant resources will stagnate while concessional loans will most likely increase. Most concessional loans are targeted towards MICS and LMICS which means resources for LDCs will most likely diminish both in relative and absolute terms. In order to ensure that the poorest countries are not adversely affected by the push towards debt financing we would recommend that:

Replace the 10% reference rate with a more relevant benchmark in determining the grant element of ODA loans - Assessing a donor's opportunity costs on the basis of a 10% reference rate created in the 1970s is inappropriate. From 2008 to the present, this inflated rate has allowed loans provided at higher interest rates than commercial loans from multilateral institutions to pass the 25% grant element test and count as ODA. This rate overvalues the concessional element of loans. With a lower rate, such as that used by the IMF, the grant element would be significantly lower: 50% lower than the reported $1 billion in the case of loans made by France and Germany in 2010. To prevent such problematic reporting from happening, the new benchmark should be better aligned with interest rates at which donors can borrow their funds. The DAC could draw lessons from the system used by the IMF and agree with its stakeholders on the most appropriate rate.

Deduct interest repayments from net ODA - Actual amounts of ODA transferred to developing countries are inflated by interest on loans. In 2012, developing countries repaid €590 million of interest to EU institutions and EU governments that were not captured in ODA reporting. Interest repayments should be deducted from ODA figures for net ODA to provide a genuine representation of flows to and from developing countries.

[3] http://drp.dfcentre.com/project/tax-exemptions-aid-agencies-and-institutional-capacity-tanzania-revenue-authority
[4] http://www.development-today.com/magazine/2011/dt_14-15/news/proposes_ending_tax_exemption_for_aid_projects
[5] https://www.un.org/esa/ffd/tax/firstsession/ffdtaxation-tax%20aspects.doc

Count only the grant element as ODA - Donors should be incentivised to provide loans with the highest degree of concessionality. Only the concessional component of a loan represented by the grant element should be reported as ODA. The DAC can build on the existing methodology for associated financing where ODA is mixed with other types of financing but only the concessional element is counted as ODA. The determinant for the grant element should also be carefully considered. Basing a grant element on a risk determined discount rate could have the perverse incentive of valorising loans to countries with a high probability of default which has long term negative ramifications for the recipients. Basing the grant element on other benchmarks such as the differentiated discount rate for export credits makes more sense at it would not drastically distort aid figures and better reflects donor effort.

Donors should not be incentivised to deliver their aid commitments in the form of loans - The DAC's recommendation to reach an average grant element of 86% in bilateral aid commitments and to deliver their aid to least developed countries essentially in the form of grants should be turned into a requirement. This requirement would incentivise donors to maintain an appropriate balance between grants and loans, and continue to use grant financing in countries where it is most needed.

Add a debt sustainability criterion - Concessional loans should be used with the greatest caution as they threaten to reverse the sustainable levels of debt achieved in most partner countries. Concessionality requirements should not be uniform but should be tailored to the debt situation of borrowing countries. The DAC can build on the IMF system of higher concessionality for low-income countries at risk of debt distress (i.e. 35% grant element) but should tighten them further by only allowing loans with high levels of concessionality.

IV. Options for focusing ODA were it is needed most

CONCORD AidWatch is convinced that poor people matter wherever they live. Hence, poor **people living in Middle Income Countries cannot be left behind** and a revised DAC recipient list cannot assume that their governments will be willing and able to deal with eradicating poverty, fight against inequality and adaptation towards a more sustainable development. ODA is still needed in middle- as well as low-income contexts, by for example playing a game-changing and human-rights-supporting role in development there[6].

CONCORD AidWatch believes that a country's income status is not sufficient to give a true and accurate picture of its population's living conditions. Other **indicators, such as development, inequality and vulnerability criteria, should be brought into the calculations**. While it generally increases in parallel with rising GDP, economic inequality is likely to hamper the eradication of poverty and can damage social cohesion, thereby contributing to conflict and fragility. Inequality along other dimensions such as gender, ethnicity, social class, caste, HIV status or disability can also lead to discrimination against people who tend to be part of the most vulnerable and often also the poorest groups in society. Therefore, ODA should be empowering these groups, both as an end in itself and because it is the most effective way to tackle poverty.

[6] Sumner A (2010), Global Poverty and the New Bottom Billion, Institute for Development Studies

Similar debate has already taken place on the EU level, and the European Parliament[7] proposed the following criteria for ODA eligibility

- Human Development Index: below 0,75;
- Poverty headcount ratio (based on daily per capita net income of USD 2 (PPP) (% of the population); above 10 %
- Poverty Gap Index (based on daily per capita net income of USD 2): above 4 %; and
- Income Gini Coefficient: above 45 %.
- Upper Middle Income Countries for which not all, no reliable or no recent data for points (a) to (d) are available may continue to be eligible for country-specific cooperation programmes.

CONCORD AidWatch thinks that inequality and vulnerability are crucial factors to take into account when deciding on the future list of ODA recipient countries.

[7] EP position on DCI, Title I, Article 1c (Amendments 33-34).